91-1127

Supreme Court, U.S.
FILED
JAN 7 1992
OFFICE OF THE CLERK

No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

ANTHONY J. ACCARDO and CLARICE J. ACCARDO,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

Does the administration of the tax laws of the United States permit the discretion to impose a penalty for the successful assertion of rights guaranteed under the Fifth and Sixth Amendments to the Constitution?

a. Where, as noted by the Court of Appeals, there is a paradoxical situation that if one pleads not guilty to a charge of violating the RICO statute which seeks a forfeiture judgment, is tried by a jury, and is convicted and a judgment of forfeiture is entered, he may deduct his legal fees incurred in defense from his federal income tax, but if one pleads not guilty to the same charge, is tried before the same jury, and is acquitted, he may not deduct his legal fees, is not the latter penalized for the successful assertion of his constitutional rights?

b. Whether petitioners are entitled to a tax deduction pursuant to section 212 of the Internal Revenue Code for legal fees incurred in the successful defense of a RICO prosecution which included a count of forfeiture seeking a forfeiture judgment of over $2 million?

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PETITION FOR WRIT OF CERTIORARI

OPINION BELOW

The opinion of the United States Tax Court decided February 27, 1990 is reported at 94 T.C. No. 8. The opinions and order of judgment are in the Appendix to this Petition. *See* Appendix A, B, C. A timely Petition for Rehearing was denied by order entered October 9, 1991. *See* Appendix B.

JURISDICTION

The opinion of the United States Court of Appeals for the Seventh Circuit was decided on August 21, 1991; *See* Appendix A. The order denying the timely Petition for Rehearing was entered October 9, 1991. *See* Appendix B.

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. Section 1254 and Supreme Court Rule 10 *et seq.*

STATUTES INVOLVED

18 U.S.C. Section 1962	Appendix D
18 U.S.C. Section 1963	Appendix E

Internal Revenue Code

26 U.S.C. Section 162	Appendix F
26 U.S.C. Section 212	Appendix G
26 U.S.C. Section 6653	Appendix H
26 U.S.C. Section 6661	Appendix I

STATEMENT OF THE CASE

On June 3, 1981, Petitioner Anthony J. Accardo was indicted by a federal grand jury in the Southern District of Florida and charged along with fifteen other persons of having conspired "to conduct and participate, directly and indirectly, in the conduct of the affairs of the Laborers Union through a pattern of racketeering activity" in violation of the Racketeer Influenced Corrupt Organization statute (hereinafter RICO) (18 U.S.C. Section 1962(c)). Joint exhibit 2 B Doc. No. 21. Pursuant to the penalty provision of the RICO statute (18 U.S.C. Section 1963) a joint and several judgment of forfeiture to the United States in excess of $2,000,000.00 was also south. *Id.* at 18-19.

Following a ten week jury trial in 1982, Petitioner Accardo was acquitted and no forfeiture judgment was ever entered against him. Exhibit D, Doc. No. 21, (Judgment of Acquittal). However, as a result of the trial, eight forfeitures were entered against most of those convicted. *United States v. Caporale*, 806 F.2d 1487, 1505-1509 (11th Cir. 1986).

In defending the indictment, Petitioner was represented by attorneys Carl M. Walsh, and Edward M. Kay. Stipulation of Fact 6, Doc. No. 21. Petitioner incurred and paid legal fees in defense of the indictment in the amounts of $17,500.00 in 1981 and 1982. Petitioners Anthony J. Accardo and his wife Clarice Accardo filed joint income tax returns in tax years 1981 and 1982. (Clarice Accardo is a party only because she filed a joint return with her husband. All references to "petitioner" in the singular will be to Anthony J. Accardo.)

The legal fees incurred and paid were claimed as an itemized deduction on the respective tax returns as "Legal Fees Re: Conservation of property held for production of income." Exhibit 3 G, Doc. No. 21, (1982 return).

The Petitioners generated a substantial amount of their income from certain certificates of deposit. The income produced by those certificates of deposit constituted approximately 74% of their income in 1981 and approximately 58% of their income in 1982. *Id.*

The government, by the IRS, determined deficiencies in the federal income tax and imposed additions to the tax for the years 1981 and 1982. The amount totaled over $60,000.00 + 50% of the interest due on the deficiency. *Accardo v. Commissioner*, 94 TC No. 8 (Doc. No. 39577-87). (Reproduced in the Appendix hereto at Appendix C)

The Accardo's filed a Petition for Redetermination of Deficiency in the United States Tax Court pursuant to 26 U.S.C. Section 6214. The Tax Court found for the Respondent, the Commissioner of Internal Revenue. *Id.* The Accardo's then moved the Tax Court to vacate or revise its decision. Doc. No. 32. This petition was denied. Doc. No. 34. Petitioners Anthony J. and Clarice Accardo appealed that decision to the United States Court of Appeals for the Seventh Circuit pursuant to 26 U.S.C. Section 7843, Rule 13 of the rules of Appellate Procedure, and Tax Court Rule 190. The Seventh Circuit affirmed the determination of the Tax Court by opinion dated August 21, 1991. Appendix A.

Petitioners timely filed a Petition for Rehearing which was denied October 9, 1991. Petitioners now petition this Court for a Writ of Certiorari to hear this matter.

REASONS FOR GRANTING THE WRIT

This case presents an issue of first impression to this Court of whether legal fees are deductible when incurred to conserve income producing property arising from a RICO forfeiture prosecution. In denying Petitioner's appeal, the Seventh Circuit recognized the unfairness presented by the situation at bar and characterized this unfairness stating, "[t]his case presents the somewhat paradoxical situation in which the IRS treats convicted taxpayers more favorably than acquitted taxpayers." *Accardo v. C.I.R.*, 942 F.2d 444, 446 (1991). The IRS' construction of the deduction of legal fees from a RICO prosecution has allowed the deduction under IRC Section 162, a business deduction, for those convicted of being involved in the alleged criminal enterprise. The IRS reasoning is that the expenses incurred in the course of a trade or business, albeit an illegal trade or business. By exercising his constitutional rights, denying the charges against him, being tried before a jury, and being acquitted of the charges, the business expense deduction is not available to Petitioner. However, Petitioner was charged under RICO and a forfeiture in excess of two million dollars was sought.

This threat of forfeiture is one of an *in personam* nature which could and would be executed against any and all of his assets. Petitioners' most obvious assets against which the government would execute forfeiture had it been successful in its prosecution are Petitioners' certificates of deposit, which are his primary source of income. Therefore, defense against the prosecution was a defense of his income producing property and legal fees incurred from

that defense are deductible under 26 U.S.C. Section 212 as expenses incurred in the conversation of income producing property.

The Seventh Circuit, in its opinion, misstated the nature of the *in personam* judgment and failed to recognize that the broad scope of RICO has changed the rules as to when and what the government may recover against a defendant.

The Seventh Circuit failed to appreciate the broad scope of RICO forfeiture and the broad "forfeitable interest" as defined by this Court in *Russello v. United States*, 464 U.S. 16, 104 S. Ct. 296 (1983). When this type of broad-based definition is joined with the *in personam* nature of the action and the "no-tracing" requirement against assets, the conclusion is that Petitioners' income producing assets would have been forfeitable, had a judgment been entered. The Seventh Circuit misstates the law in two respects: The first misstatement is that Petitioners' income producing assets were not forfeitable under RICO, its second misstatement is that the legal expenses incurred in defense were not deductible.

It is this second part of the issue which brings to this Court the unique question of how the broad criminal power of the RICO Act should come to play when removed from that arena and placed into the taxpayers setting.

ARGUMENT

PETITIONERS ARE ENTITLED TO DEDUCT LEGAL FEES INCURRED IN DEFENSE OF A RICO FORFEITURE AS A DEDUCTION UNDER 26 U.S.C. SECTION 212(2) WHERE THE EXPENSES ARE INCURRED TO CONSERVE INCOME PRODUCING PROPERTY DUE TO THE *IN PERSONAM* NATURE OF RICO FORFEITURE.

Petitioner Accardo defended himself against a criminal RICO indictment which also sought a forfeiture judgment in excess of $2,000,000.00 against Petitioner. The legal fees incurred and paid in defense of this indictment were claimed as an itemized deduction on their 1981 and 1982 tax returns as legal fees incurred for the conservation of income producing property, pursuant to 26 U.S.C. Section 212(2).

The Petitioners generate a majority of their income as interest from certificates of deposit. *See* Exhibits 3-G and 4-H, Doc. 21 (Petitioners' 1981 and 1982 tax returns). They also had additional income in the form of gains realized from the sale of certain real estate in tax years 1981 and 1982. The indictment of June 3, 1981, charged petitioner Accardo in violation of the RICO statute (18 U.S.C. Section 1962) and sought a forfeiture judgment in excess of $2,000,000.00. *United States v. Caporale, et al.*, 806 F.2d 1487, 1505-1509 (11th Cir. 1986).

In defense against the indictment and in order to protect his income producing property from forfeiture, Petitioner hired attorneys and incurred legal fees. Following an eight week jury trial and two weeks of jury deliberations, Petitioner Accardo was acquitted of the charges against him.

Petitioners then claimed the legal fees actually incurred and paid as specific itemized deductions on their 1981 and

1982 tax returns pursuant to IRC Section 212(2). The expense of legal fees for this prosecution was to conserve the Petitioners' income producing property, that is, the certificates of deposit from which they generated most of their income and to which the government would look to had its prosecution been successful.

The test for the deductions at issue is based on the decisions of *United States v. Gilmore*, 372 U.S. 687, 689, 86 S. Ct. 1118, 16 L. Ed. 2d 185 (1966). In *Gilmore*, the United States Supreme Court held that "[t]he principle we derive from these cases is that the characterization as 'business' or 'personal' of the litigation costs of resisting a claim depends on whether or not the claim *arises in connection with* the taxpayer's profit-seeking activities." 372 U.S. at 48 (emphasis in original). The test derived is that court should look at the origin and nature of the claim to determine its deductibility.

In *Tellier*, the Supreme Court affirmed the origin and character of the claim test and there allowed the deduction of legal fees in defense of a criminal prosecution since it found that the criminal charges originated from the taxpayer's trade or business. 383 U.S. 687. The respondent taxpayer was in the business of underwriting public stock offers and unsuccessfully defended himself in a criminal prosecution for violations of the Securities Act of 1933 and the mail fraud statute. The question presented was whether he could deduct the legal expenses incurred in defense of that prosecution under IRC Section 162(a).

Id. at 689. The Court affirmed the test that it is the origin and character of the claim with respect to which an expense was incurred. *Id.* The Court also found the deduction was not against public policy and should not be denied absent an exclusion by Congress. The Supreme Court stated:

> Congress has authorized the imposition of severe punishment upon those found guilty of the serious criminal offenses with which the respondent was charged and of which he was convicted. But we can find no warrant for attaching to that punishment an additional financial burden that Congress has neither expressly nor implicitly directed. To deny a deduction for expenses incurred in the unsuccessful defense of a criminal prosecution would impose such a burden in a measure dependent not on the seriousness of the offense or the actual sentence imposed by the Court, but on the cost of the defense and the defendant's particular tax bracket. We decline to distort the income tax laws to serve a purpose for which they were neither intended nor designed by Congress.

Id. at 694-695.

This Court in *Gilmore* and *Tellier* has made clear that the test for deductibility as a business expense (IRC Section 162) or expense for the production of income (IRC Section 212) is the origin and character of the claim. The forfeiture section of the RICO statute was originally enacted in 1970. The decisions in *Gilmore* and *Tellier* were handed down years before that and did not deal with the nature of RICO claim. *Gilmore* and *Tellier* clearly indicate the problem in the instant case. Both cases are quite clear as to the origin and character of the original claim.

Gilmore involved a divorce and *Tellier* involved SEC violations by a stock underwriter. However, neither case, nor any related subsequent case, established standards or criteria to make a determination between "business" and "personal" as to the origin and character of the original claim. IRC code Section 262 has a lot of examples and cases considering the "personal" origin, but it does not establish objective criteria. In the instant case the government took the position in the original case that the defendant was in the trade or business of racketeering.

Had he been found guilty, there is little doubt that the legal fees would have been deductible under Section 162, pursuant to *Tellier*. Because Petitioner was acquitted, the Tax Court has taken the position that the origin was personal. Again, the court is reminded that this is a case of first impression, since no case has decided the deductibility of expenses incurred in defending a RICO forfeiture indictment.

In the instant case the origin of the claim against Accardo threatens his income generating activities and therefore cannot be classified as "personal".

The RICO statute changed the then existing law regarding forfeiture of assets. Prior to RICO a forfeiture had been *in rem*, a forfeiture could be taken against the specific proceeds of the illegal activity or against assets or property used in the commission of the crime. The RICO statute changed the *in rem* nature of the forfeiture and made the forfeiture an *in personam* judgment as part of the punishment.

The forfeiture provision, 18 U.S.C. Section 1963(a) provided that individuals convicted of violating the statute forfeits any and all interest acquired or maintained in violation of the statute.

The nature of this forfeiture is *in personam*, that is, it is a judgment against the person as distinguished from a judgment only against property *(in rem)*. Such a judgment can be executed against any of the defendant's assets. *See* Rule 69, F.R.C.P. Further an *in personam* money judgment pursuant to 18 U.S.C. Section 1963 can executed against any assets of a defendant without any requirement upon the government to trace the assets to an illegal source. *See, e.g. United States v. Robilotto*, 8238 F.2d

940 (2nd Cir 1987); *United States v. Ginsberg*, 773 F.2d 798 (7th Cir 1985); *United States v. Navarro-Ordos*, 770 F.2d 959 (11th Cir. 1985).

In *United States v. Ginsberg*, 773 F.2d 798, 800-801 (7th Cir. 1985), the Seventh Circuit stated:

> The forfeiture penalty incorporated in Section 1963 differs from other presently existing forfeiture provisions in federal statutes. Under other statutes, the forfeiture proceeding is in rem against the property, since the property being forfeited is itself considered the offender, and the forfeiture is no part of the punishment for criminal offense. By enacting Section 1963, however, Congress revived the concept of forfeiture as a criminal penalty against the individual, since the proceeding is in personam against the defendant and the forfeiture is part of the punishment.

(quoting *United States v. L'Hoste*, 609 F.2d 796, 813 no. 15 (5th Cir.), *cert. denied*, 449 U.S. 833 (1980).

In *Ginsberg*, the defendant appealed a RICO forfeiture judgment because the government had not established that he possessed or controlled any of the money he had received through his illegal activities. 773 F.2d at 799. The court rejected his argument and focused on the nature of the forfeiture provision. Finding that the forfeiture is a "sanction against the individual defendant rather than a judgment against the property itself," the court found that the government need not be able to trace the funds received illegally, but only that it establish the amount. *Id.* at 801.

In its opinion here, however, the Seventh Circuit concludes that though the RICO forfeiture "represents an *in personam* criminal penalty rather than an *in rem* proceeding to take possession of specific property, this does not subject any and all property belonging to a convicted

criminal to forfeiture under RICO." 942 F.2d at 447. That is not the nature of an *in personam* judgment.

While it is true that before a judgment will issue in a forfeiture proceeding the Government must establish that profits and proceeds were acquired by a particular defendant though the racketeering activity, there is no requirement of tracing the illgotten gain to one's present assets.

The court below misinterprets the nature of the RICO forfeiture. As an *in personam* proceeding, the forfeiture is against the person directly. If a judgment had been entered against Petitioner, it could be executed against any of his assets, including his most readily seized assets, his certificates of deposit.

In *Russello v. United States*, 464 U.S. 16, 104 S. Ct. 296, 78 L. Ed. 2d 17 (1983), the Supreme Court held that the forfeitable "interest" is necessarily broad in its examination of the RICO statute. The court found that the statute was written to have a strong impact in the areas against which it was to be used. "It undoubtedly was because Congress did not wish the forfeiture provision of Section 1963(a) to be limited by rigid and technical definitions drawn from other areas of the law that it selected the broad term 'interest' to describe those things that are subject to forfeiture under the statute." *Id.* at 21, 104 S. Ct. at ____, 78 L. Ed. 2d at 23. That case dealt with the forfeiture of insurance proceeds received by members of an arson ring. The court there found the 'interest' to extend beyond the primary interest in the criminal enterprise.

Underlying the present case are charges against the petitioner of accepting kickbacks from a union insurance program. The allegation of a forfeitable interest from the enterprise in which the petitioner was accused of partici-

pating, is similar to the interest held by the defendants in *Russello. See also, United States v. Martino*, 681 F.2d 952 (1982).

When this type of broad-based definition of a forfeitable interest is joined with the *in personam* nature of the forfeiture and the no-tracing requirement against assets would have been forfeitable, had a judgment been entered. This Court's conclusion that Petitioner's income producing property was not threatened with forfeiture is erroneous.

The court below hinged its decision on its initial conclusion that the Petitioner's income producing property was not forfeitable. This is a false conclusion. Because the threat of forfeiture was against the Petitioner personally, it did affect his income producing property. The court's opinion seems to suggest that because he was successful, there was no threat of forfeiting his income producing property. The Petitioners' acquittal does not destroy the propriety of the deductions. The court must still look to the origin and nature of the claim and find the expenses were to protect their income producing property.

In this instance, Petitioner Accardo sought to conserve his income producing property, the certificates of deposit held in petitioners' names. It is these assets which are the most liquid and are the most obvious target for execution of a forfeiture judgment had the forfeiture judgment been obtained.

It is the origin and character of the claim against petitioner Acccardo, pursuant to the test in *Gilmore* and *Tellier*, that by seeking a forfeiture judgment against Accardo, the government was, in effect seeking a judgment to forfeit the petitioners' income producing property, the certificates of deposit. Therefore, the deduction of attorney's fees were properly taken pursuant to IRC Section 212(2).

The government argues that Treasury Regulation 1.212-1(m) would bar petitioner's claim . However, this fails to address the argument. Petitioner Accardos' defense against the indictment was a defense of his and his wife's income producing property.

Petitioner relies on the decisions in *Ruoff v. C.I.R.*, 277 F.2d 222 (3d Cir. 1960) and *Petschek v. United States*, 335 F.2d 734 (2d Cir. 1964). These cases support the proposition that legal fees paid in defense to protect their income producing property are deductible under Section 212(2). *Ruoff* held legal fees expended in defense against a forfeiture by the Attorney General to be deductible. 277 F.2d 222.

In *Ruoff*, the Third Circuit allowed the deduction of attorneys fees paid to conserve income producing property. (The deduction was pursuant to Section 23(a)(2) of the IRC now renumbered as Section 212(2). In *Ruoff*, the U.S. Attorney General had issued a vesting order, vesting all of Ruoffs' property in himself, pursuant to the Trading With the Enemy Act of 1917, 50 U.S.C. Appendix, Section 1 *et seq. Id.* at 224. Ruoff had retained attorneys to pursue a legal remedy and eventually entered into a stipulation with the Attorney General settling the matters. *Id.*

Subsequently, Ruoff deducted the legal fees as an expenses to conserve income producing property. The IRS disallowed the deduction, and the Tax Court affirmed. The Third Circuit reversed, rejecting the government's position that the legal expenses Ruoff were incurred in "defense of title" or in an attempt to regain title in her property. *Id.* at 206. Quoting the dissenting judge from the Tax Court's consideration of *Ruoff*, the court stated:

> It seems to me that the claimant was merely pursuing her statutory rights to prevent (if she can

> prove her case) the ultimate confiscation of her property, and that her action in so doing was one of conservation of her basic interest in the property within the meaning of Section 23(a)(2). [renumbered Section 212(2).]

Petschek was the prosecution of a claim for compensation because of a foreign government's forfeiture of property. 335 F.2d 734. The legal fees expended there were also deductible as expenses for the management, conservation, or maintenance of property held for the production of income. *Id.* In *Petschek*, the government of Yugoslavia confiscated Yugoslav corporations, including several corporations in which Petschek had owed stock and from which he generated income. *Id.* at 735. Thereafter, the United States settled with Yugoslavia as to claims of U.S., nationals and set up an International Claims Commission. *Id.* Petschek incurred legal fees in the prosecution of his claims for compensation and deducted those fees and expenses for the management, conversation, or maintenance of property held for production of income. The IRS disallowed the deductions and Petschek sued for a refund.

In reversing the district court's dismissal of Petshcek's claim, the Second Circuit also found that these were not capital expenditures in defense of title to property or to reacquire title. The court cited *Ruoff*, 277 F.2d 222, for the proposition that "[w]hen a government has taken possession of property held by a taxpayer for investment, expenses incurred to regain this are deductible under Section 212." 335 F.2d at 736.

Applying these cases to the instant case, petitioners are also entitled to deduct the legal fees incurred in defense of the RICO prosecution. The defense of RICO forfeiture sought to prevent the loss of petitioner's income produc-

ing property. Here, the indictment, the initial pleading, sought an *in personam* money judgment against petitioner Accardo of in excess of two million dollars. His visible assets, petitioners' certificates of deposit, were his primary source of taxable income. By analogy to the holdings in *Ruoff* and *Petschek*, the legal fees incurred here are deductible.

This income producing property the petitioners sought to conserve are certificates of deposit. These assets are effectively equivalent to cash since they represent on amount of money on deposit with the particular financial institution.

There are no capital costs to the acquisition or improvement of cash money. The certificates of deposit are worth the same amount of money at the end of their term as they were on the day of deposit. Therefore, the legal expenses are not capital expenditures to the petitioners' assets. The legal fees at issue here are properly deductible as expenses for the conservation of income producing property.

Additions To Tax Are Not Properly Sustained

The court below erroneously found the petitioners' deductions under IRC Section 212 to be improper and therefore no additions to tax are due. Even if the tax deficiency were proper, any additions are in error.

The petitioners did rely on the advice of their professional tax preparer and their attorney. The court erroneously concludes to uphold the penalties because there was a lack of substantial authority to support petitioners' deductions. While it is true there are no cases exactly on point to this issue, the petitioners' deductions were

bases upon reasonable legal analysis and a plain reading of the statute. The petitioners took the deductions in good faith and should not be additionally penalized because it is a case of first impression.

Even if this Court were to disallow petitioners' deduction, it would still be improper to impose additions to tax as penalties. It is improper to impose a penalty pursuant to IRC Section 6653 when the taxpayer had made an honest mistake of law, even if such a view is untenable. *See, e.g., Kenn v. Commissioner*, TC Memo 1981—313, 42 TCM 170 (1981); *Dillin v. Commissioner*, 56 TC 228 (1971); *Seaman v. Commissioner*, TC Memo 1965-15 24 TCM 78 (1965).

Finally, there are no cases prior to the opinion filed in this case holding legal fees expended in successfully defending an indictment charging an offense under the RICO Act and specifically seeking an *in personam* forfeiture judgment are not deductible.

Even co-defendants of petitioner Accardo who were convicted and had forfeiture judgments entered against them were allowed the deduction. *See e.g., Pilotto v. C.I.R.*, TC No. 223991-86. Even as a settled case with the I.R.S., petitioners' cite this case as authority to show the legitimacy of their belief in their claim and in the uncertainty as to law regarding the deduction.

The petitioners maintain that the deductions were proper and no tax or additions to tax are due. However, even if a tax deficiency were found, the deductions were taken in good faith, making it improper to impose such a penalty. Therefore, this Court should find that there are no additions to tax due.

CONCLUSION

For the foregoing reasons, Petitioners pray that this Petition for Writ of Certiorari be granted.

Respectfully submitted,

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Dated: January 7, 1992

APPENDICES

APPENDIX A

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 90-2649

ANTHONY J. ACCARDO and
CLARICE ACCARDO,

Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL
REVENUE,

Respondent-Appellee.

Appeal from the United States Tax Court.
No. 39577-87—**Charles Clapp II**, *Judge.*

ARGUED MAY 16, 1991—DECIDED AUGUST 21, 1991

Before CUMMINGS, CUDAHY and RIPPLE, *Circuit Judges.*

CUMMINGS, *Circuit Judge.* This case presents the somewhat paradoxical situation in which the IRS treats convicted taxpayers more favorably than acquitted taxpayers. The Internal Revenue Code affords a tax break for the former while the latter may not deduct any portion of the same kind of expense. We must decide whether a taxpayer may deduct the legal fees committed to the successful defense of a criminal prosecution under the Racketeer Influenced and Corrupt Organizations Act ("RICO") (18 U.S.C. § 1961 *et seq.* (1970)). Anthony J. Accardo was

charged along with fourteen other defendants for racketeering activities which allegedly earned the defendants $2 million in kickbacks from a union insurance program. See *United States v. Guzzino*, 810 F.2d 687, 690 (7th Cir. 1987), certiorari denied, 481 U.S. 1030. Accardo was one of three defendants acquitted, while the remaining eight were convicted and sentenced.[1] *Id.* at 690 n.6. In this appeal, Accardo relies solely on Section 212(2) of the Internal Revenue Code, which permits deductions of funds expended "for the management, conservation, or maintenance of property" in the course of business. Because the statutory scheme under RICO includes a general forfeiture provision that potentially reaches the assets of a taxpayer which are derived from racketeering activity, this taxpayer contends that he defended the suit in part to protect his assets (*i.e.* several certificates of deposit) from forfeiture. The Commissioner of Internal Revenue denied the taxpayer his deduction, finding there to be substantial deficiencies instead.

Petitioners Anthony J. and Clarice Accardo[2] filed suit in the United States Tax Court to challenge the asserted deficiencies. The major deficiencies for 1981 and 1982 added up to approximately $50,000, because the Commissioner ruled that they may not deduct legal expenses totaling $224,500 incurred in successfully defending the RICO criminal prosecution. In arriving at this conclusion, the Commissioner denied that Section 212(2) of the Internal Revenue Code permitted the deduction claimed by the taxpayer. The Commissioner also claimed the following additions to tax: $2,491 under Section 6653(a)(1) which imposes a penalty for the negligent underpayment of income

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[1] The RICO convictions of the eight guilty defendants were upheld in *United States v. Caporale*, 806 F.2d 1487, 1497 (11th Cir. 1986), certiorari denied *sub nom. Gopman v. United States*, 482 U.S. 917.

[2] Clarice Accardo is a party only because she filed a joint income tax return with her husband. In this opinion, all references to "taxpayer" will be to Anthony J. Accardo.

taxes; 50 percent of the interest due on the deficiency under Section 6653(a)(2); and $9,903 under Section 6661 governing the substantial understatement of income tax. The Tax Court upheld the amounts claimed by the Commissioner. Its opinion is reported in 94 T.C. 96 (No. 8) (1990). We affirm.

I. DEDUCTIBILITY OF LEGAL FEES IN DEFENDING RICO PROSECUTION

The RICO indictment claimed that because of his racketeering activity, taxpayer's stake in the proceeds of racketeering and in the interests acquired through the use of those proceeds was subject to forfeiture as provided by then 18 U.S.C. § 1963(a) (1970).[3] Taxpayer asserts that he was attempting to protect against forfeiture assets that included three certificates of deposit totaling $1,500,000 and condominiums in River Forest, Illinois, and Indian Wells, California, used as personal residences. However, the Tax Court found that taxpayer did not use funds acquired from racketeering activities to purchase those assets (App. A13). Therefore, the assets were not forfeitable under 18 U.S.C. § 1963(a) which then provided:

> Whoever violates any provision of section 1962 of this chapter shall be fined not more than $25,000 or imprisoned not more than twenty years, or both, and shall forfeit to the United States (1) any interest he has acquired or maintained in violation of section 1962, and (2) any interest in, security of, claim against, or property or contractual right of any kind affording a source of influence over, any enterprise which he has established, operated, controlled, conducted, or

[3] Subsection (a) of Section 1963 has subsequently been amended on two occasions—in 1984, Act of October 12, 1984, Pub. L. No. 98-473, 1984 U.S. Code Cong. & Admin. News 3182 (98 Stat.) 2192, and, most recently, in 1988, Act of November 18, 1988, Pub. L. No. 100-690 (102 Stat.) 4403. The statute now provides for tougher penalties and increases the power of the courts to order forfeiture of assets to the United States.

participated in the conduct of, in violation of section 1962.

The non-forfeitability of the certificates of deposit represents an argument that has been overlooked by both sides in this appeal. Obviously, it goes against taxpayer's interest to claim that the assets are not subject to forfeiture, for it is the risk of loss that forms the sole basis of his claimed deduction. The Commissioner, on the other hand, has apparently decided as a tactical matter to assume that the certificates were subject to forfeiture but that taxpayer's legal fees were not devoted to the protection of the asset. By taking this position, the Commissioner, acting on the Government's behalf, seemingly leaves the door open for forfeiture of this type of asset in the event that taxpayer has been convicted of racketeering activity and also denying the deduction.

The law of RICO, however, clearly prevents forfeiture of this type of asset. Despite the fact that RICO's forfeiture penalty differs fundamentally from other federal forfeiture provisions in that a RICO forfeiture represents an *in personam* criminal penalty rather than an *in rem* proceeding to take possession of specific property, this does not subject any and all property belonging to a convicted criminal to forfeiture under RICO. Courts have interpreted Section 1963(a) of the RICO statute to require that as a prerequisite to the forfeiture, the Government must prove that at the time of conviction the forfeitable assets were profits and proceeds stemming from racketeering activity. *United States v. Ginsburg*, 773 F.2d 798, 800 (7th Cir. 1985) (*en banc*), certiorari denied, 475 U.S. 1011. As discussed in *Ginsburg*, the RICO forfeiture "deprives that defendant of all of the profits and proceeds that he has acquired *through racketeering activity* * * * and does not attach until the defendant is convicted of the crime for which the forfeiture is imposed." *Id.* at 801 (emphasis supplied). Accordingly, as long as the asset was acquired through illegal activity at the time of conviction, it is forfeitable in its entire amount, even if the defendant transfers the actual property to another party. *Id.* at 802 ("a racketeer who dissipates the profits or proceeds

of his racketeering activity on wine, women, and song has profited from organized crime" and may be required under Section 1963(a) to forfeit an amount equal to his ill-gotten gain); *United States v. Madeoy*, 912 F.2d 1486, 1495 (D.C. Cir. 1990) (Government could order forfeiture of all properties related to RICO enterprise), certiorari denied, 111 S. Ct. 1008; *United States v. Angiulo*, 897 F.2d 1169, 1210 (1st Cir. 1990) (comparing "proceeds or profits and property affording a source of influence [over a racketeering enterprise] which are only subject to forfeiture to the extent they are tainted by the racketeering activity" to illegally obtained interests "*in* an enterprise, which are forfeitable regardless of percentage of taint") (emphasis in original), certiorari denied *sub nom. Granito v. United States*, 111 S. Ct. 130; *United States v. Busher*, 817 F.2d 1409, 1412-1413 (9th Cir. 1987) (stating that "Section 1963 is purposely broad * * * [and was] designed to totally separate a racketeer from the enterprise he operates"), citing *Russello v. United States*, 464 U.S. 16, 26-27.

The forfeiture provision of Section 1963(a) does not encompass the certificates of deposit in this case. The Government has not carried its burden and shown that the certificates would have been forfeitable, for as the Tax Court found (App. A13), there is no connection between them and the alleged racketeering activity, here the alleged interference in union affairs and misappropriation of funds from employee benefit plans (App. A11). This finding is unchallenged. Moreover, taxpayer was acquitted of any RICO violations stemming from this prosecution. His innocence prevents the Government from seizing the certificates and bars taxpayer from claiming any connection between the certificates and racketeering activity.

Taxpayer hinges his argument on the connection between the RICO forfeiture and the certificates of deposit, because he has found no other basis for claiming the deduction of legal fees. He asserts that if found guilty, he might have to turn over his certificates in order to satisfy the judgment of over $2 million in RICO criminal forfeiture. This is where the paradox noted above creeps into

the picture. The Commissioner (Br. 16) concedes that those defendants who were found guilty as a result of the same RICO prosecution could properly claim a deduction for legal fees under Section 162(a) "as expenses paid or incurred * * * in carrying on any trade or business," because they were found to be engaged in the racketeering business. Section 162(a) does not draw any distinction between legitimate and illegitimate business enterprises. But since the jury acquitted taxpayer of involvement in the racketeering business, he could not claim a Section 162(a) deduction and therefore chose to rely instead on Section 212(2).

Ironically, because taxpayer was not convicted of racketeering—indeed, we have no idea what his business is because taxpayer refused to answer the Commissioner's interrogatory concerning his occupation, citing the fifth amendment privilege against self-incrimination (Doc. 18, Record on Appeal)—taxpayer was reduced to claim that he incurred the legal fees to conserve and maintain the three certificates of deposit which were income-producing property within the meaning of Section 212(2) of the Code.

Taxpayer was mistaken as to the operation of RICO's forfeiture provision in this case. Pursuant to then Section 1963(a) of the Criminal Code (18 U.S.C. § 1963(a) (1970)), the indictment sought the forfeiture only of interests acquired and maintained from racketeering or acquired through the use of the proceeds therefrom (App. A12). No racketeering funds were used to purchase the three certificates of deposit (App. A13). Moreover, taxpayer wishes to claim a deduction for the entire amount of the legal fees incurred in defending against the RICO prosecution. He implies that if the entire amount is deductible, then all of the legal fees were directed at protecting his certificates of deposit while none of the fees were incurred to conserve and maintain the condominiums and to keep him from prison. In any event, since the three certificates of deposit were not obtained from the alleged racketeering activities or from proceeds thereof, they were not forfeitable under

then 18 U.S.C. § 1963(a), thus destroying taxpayer's argument that he spent $224,500 to conserve or maintain the certificates under Section 212(2) of the Code.

A. *Deductibility of legal fees generally*

In holding that no part of the legal fees is deductible, the Tax Court cited *Lykes v. United States*, 343 U.S. 118, a case that explains the limitations on the deductibility of legal fees. In *Lykes*, the Supreme Court held that under Section 23(a)(2) of the 1939 Code, the predecessor to Section 212(2) of the 1954 Internal Revenue Code,[4] the legal fees committed to contesting the amount of federal gift tax were not deductible. In discussing its holding, the Court stated that "[l]egal expenses do not become deductible merely because they are paid for services which relieve a taxpayer of liability. * * * It is not a ground for defense that the claim, if justified, will consume income-producing property of the defendant." *Id.* at 124-126. Although Congress passed a statute specifically reversing *Lykes* as it applies to gift tax, the decision applies to the case at hand, insofar as it logically establishes that the remote possibility that income will be consumed in order to satisfy an adverse judgment is not enough to permit deductibility for the conservation of assets. The nexus between the legal fee and the business asset must be closer than that.

Here the link between the legal fee and the certificate of deposit is similarly attenuated. Taxpayer hired a lawyer because he was indicted for racketeering activity, a federal crime. Additionally, because RICO's forfeiture provision also prevents the criminal from savoring the fruits of his ill-gotten gain, a finding of liability will expose the defendant to financial liability as well as prison. However, be-

[4] Section 212(2), on which taxpayer relies, was codified in the Internal Revenue Code of 1954 (26 U.S.C.), 68A Stat. 69, and remains unchanged by the Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2085, Sec. 2.

cause his certificates of deposit do not relate directly to the alleged activity (App. A13), the link between the legal fee and the claimed deduction is non-existent.

In *United States v. Gilmore*, 372 U.S. 39, a case interpreting *Lykes*, the Supreme Court offered further clarification of the principle that compels our analysis. In *Gilmore*, the Court held that a taxpayer in a divorce proceeding may not deduct legal fees incurred to resist the claims by his wife to certain of his income-producing assets. The Court stated that the possibility that an adverse judgment against the taxpayer would require him to hand over some of his assets to his wife does not permit him to deduct the legal fees. Rather, the Court looked to "the origin and character of the claim with respect to which an expense was incurred, rather than its potential consequences upon the fortunes of the taxpayer." *Id.* at 49. Therefore, because the taxpayer in *Gilmore* paid a lawyer to defend him in divorce proceedings, the possibility that a finding of liability might require him to satisfy his wife's claims by turning over income-producing assets was insufficient grounds to invoke Section 23(a)(2), the precursor to Section 212(2).

We need not dwell further on the distinction between the origin and consequences of the claim, because under the version of Section 1963(a) of the Criminal Code in force at the time of trial, forfeiture of these certificates of deposit was not even a consequence of a successful RICO claim against taxpayer. The Government's racketeering claim arose in connection with taxpayer's alleged racketeering activities but had no connection with either the certificates of deposit or the condominiums. Therefore the costs of defending against the racketeering indictment are non-deductible personal expenses under Section 262 of the Code. *Glimco v. Commissioner*, 397 F.2d 537, 540 (7th Cir. 1968), certiorari denied, 393 U.S. 981. Unlike the eight other defendants who were named in the indictment and convicted, taxpayer was acquitted of involvement in racketeering activity. Therefore, he was not engaged in a business (albeit an illegal business) that would per-

mit him to deduct the legal fees expended to defend himself. It is true that had he been convicted, taxpayer would have been able to deduct his legal fees under Section 162(a) of the Code, *Commissioner v. Tellier*, 383 U.S. 687, as did the convicted defendants, but that would be a different case. The other defendants did not rely on Section 212(2) for their deduction, claiming that their income-producing assets might be subject to forfeiture under RICO. Rather, the deduction there stemmed from a finding that the defendants were engaged in a business, and that their legal fees were specifically connected to the conduct of their business.

In addition to the principles established by *Lykes*, *Gilmore* and *Glimco*, the deductibility of a taxpayer's legal fees does not turn on the nature of the type of property to be surrendered on a finding of liability even if a potential judgment against the taxpayer might be satisfied therefrom. Consistent with the Supreme Court's decisions in *Lykes* and *Gilmore*, the Treasury Regulations under Section 212 provide:

> An expense (not otherwise deductible) paid or incurred by an individual in determining or contesting a liability asserted against him does not become deductible by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability.

Treas. Reg. § 1.212-1(m) (26 C.F.R.). As noted above, taxpayer does not claim a deduction independent from the legal fees supposedly committed to defend the certificates from forfeiture. Therefore, the fact that the certificates produce income for the taxpayer does not mean that if they were forfeitable (which they were not)[5], then taxpayer could deduct them. A court must look, as *Gilmore* commands, to the origin and nature of the claim.

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[5] See then Section 1963(a) of the Criminal Code (18 U.S.C. § 1963(a)), *supra* at 3-4.

Taxpayer relies further on *Ruoff v. Commissioner*, 277 F.2d 222 (3d Cir. 1960), and *Petschek v. United States*, 335 F.2d 734 (2d Cir. 1964), for the proposition that legal fees may be deducted when they are paid to conserve income producing property. This argument begs the question, for both decisions result from a finding that the legal fees were committed by the respective taxpayers to conserve property that was in fact linked with a trade or business. In *Ruoff*, the court permitted the deduction under Section 23(a)(2) (the precursor to Section 212(2)), because the Attorney General of the United States had seized all of the taxpayer's income-producing property pursuant to the Trading with the Enemy Act of 1915, 50 U.S.C. Appendix, Section 1 *et seq.* *Ruoff*, 277 F.2d at 229. Having actually lost possession of the property, the taxpayer was entitled to deduct the cost of retaining a lawyer in the attempt to retrieve it. The *Ruoff* taxpayer paid out legal fees specifically to defend particular property seized by the Government. *Id.*

The Second Circuit applied the same reasoning in *Petschek*, permitting the taxpayer in that case to deduct legal fees expended in an unsuccessful attempt to recover income-producing property—namely, the stock held by taxpayer in four corporations which had been seized by the nations of Yugoslavia and Rumania as part of each government's respective program for nationalizing private enterprise. 335 F.2d at 735-736.

In contrast to *Ruoff* and *Petschek*, the taxpayer in the instant case did not forfeit or lose property. He hinges his deduction on a risk of loss that is entirely speculative. The United States did not and could not require the forfeiture of the taxpayer's certificates of deposit, because, as demonstrated above, the funds used to purchase them were not obtained through racketeering (App. A13), and therefore were not forfeitable under the version of Section 1963(a) in force at the time, *supra* at 3-4. Taxpayer's legal fees bear no relation to the "conservation or maintenance of property held for the production of income" within the meaning of Section 212(2), unlike the property at issue in either *Ruoff* or *Petschek*. This case therefore

resembles *Gilmore*, 372 U.S. at 51-52, rather than either *Ruoff* or *Petschek*, for the Government's claim here did not stem from taxpayer's racketeering activities, so that his legal expenses were not deductible under Section 212(2).

B. *Taxpayer's equitable estoppel argument*

At his criminal trial, taxpayer denied that he engaged in racketeering activities under RICO and the jury agreed. It is taxpayer's acquittal and his subsequent inability to deduct legal fees as a business expense that forms the basis of taxpayer's equitable estoppel argument. As noted earlier, the Code treats the guilty more favorably than the innocent. As taxpayer correctly recognized, had he been convicted for racketeering activity, he would have been able to claim his deduction under Section 162(a), for the legal fees would have originated out of the defense of criminal charges arising from the taxpayer's trade or business. In *Tellier*, 383 U.S. at 687, the Supreme Court upheld the deductibility of legal fees as a business expense under Section 162(a) of the Code, where they were incurred in the unsuccessful defense of a criminal prosecution for securities fraud. Despite the fact that the taxpayer's gains were proffered illegally, the Court recognized that it is income nonetheless, "taxed at a rate no higher and no lower than income from more conventional sources." *Id.* at 691. Therefore, the deductibility of expenses incurred in income-producing activities must be subject to the same analysis. If the Code does not distinguish between legally and illegally earned income for purposes of income tax, then the Commissioner may not apply the deductibility provision selectively, distinguishing between the convicted and the acquitted. The Court in *Tellier* found that to deny the business expense deduction would be to turn the Code into a punitive measure where none was authorized or intended by Congress. *Id.* at 694-695. While *Tellier* would have allowed a Section 162(a) deduction if Accardo had been found to be in the racketeering business, taxpayer did not claim his deduction under that provision, nor was he found to be in that business.

Despite *Tellier*'s inapplicability to his case, taxpayer attempts to have us overlook the fact that his defense in the RICO prosecution ultimately convinced the jury that he was innocent. He asserts that the Government is estopped from denying the deductibility of the legal expenses because it previously argued that taxpayer was engaged in an illegal business activity. Therefore, according to taxpayer's equitable estoppel argument, the Government should be prevented from changing the position it took in the RICO prosecution, so that his legal fees should be deductible. This argument ignores taxpayer's unwavering denial of involvement in any racketeering activity and his acquittal at trial. In any event, because the assets were not forfeitable, taxpayer may not claim a deduction under Section 212(2).

Taxpayer also fails to satisfy the legal requirements of equitable estoppel. He did not show that he relied on any misrepresentation by the Government in changing his position for the worse, nor did the government make a misleading representation to him on which he reasonably relied to his detriment. Therefore, equitable estoppel does not apply. *Heckler v. Community Health Servs., Inc.*, 467 U.S. 51, 59; *Black v. Tic Inv. Corp.*, 900 F.2d 112, 115 (7th Cir. 1990).

II. ADDITIONS TO TAX UNDER SECTIONS 6653 AND 6661 OF THE INTERNAL REVENUE CODE

Taxpayer claims finally that since his deductions under Section 212(2) of the Code were proper, there is no liability for additions to tax. This argument fails because we have held that his legal fees were not properly deducted. Taxpayer also contends that he relied upon advice of counsel and his tax preparer in claiming these deductions, so that a negligence penalty is unjustified. Because there was no basis for deductibility, this argument is also unpersuasive. As noted previously, the funds used to purchase the assets in question were not obtained from racketeering (App. A13) and were not forfeitable under then Section 1963 of the Criminal Code, nor even sought under

the indictment (App. A12). Moreover, *Gilmore*, *Lykes*, and Treasury Regulation § 1.212-1(m) foreclose the deduction of these legal expenses even if any forfeiture claim against taxpayer might have been satisfied out of his assets. Finally, the record does not show that taxpayer believed that the law supported deductibility of the legal fees.

A. *Negligent underpayment under Section 6653(a)*

Taxpayer argues that deductibility of legal fees under Section 212(2) in a RICO prosecution presents a question of first impression. He also claims to have relied on the advice of his tax preparer in claiming the deduction. Therefore, taxpayer asks this Court to overturn the penalty he must bear for the negligent underpayment of taxes under Section 6653(a) (26 U.S.C.). Section 6653(a) of the Code acts as a check on taxpayers. If the Commissioner finds that a taxpayer has underpaid taxes, then he may recover the deficiency and may also impose an added penalty of five percent plus 50 percent of the interest attributable to the underpayment. Standard principles of negligence apply to the Commissioner's determination of underpayment, so that the penalty may be imposed when the taxpayer shows a "lack of due care or failure to do what a reasonable and ordinarily prudent [taxpayer] would do under the circumstances." *Marcello v. Commissioner*, 380 F.2d 499, 506 (5th Cir. 1967). However, taxpayer carries the burden to prove that he was *not* negligent, because the Commissioner is deemed to be *prima facie* correct as to a determination of negligence or intentional disregard of the Code. *Neely v. Commissioner*, 85 T.C. 934, 947 (1985); *Luman v. Commissioner*, 79 T.C. 846, 860-861 (1982). Furthermore, the Tax Court's determination that taxpayer failed to meet his burden that he acted with due care is a finding of fact, reviewed under the clearly erroneous standard. *Skeen v. Commissioner*, 864 F.2d 93, 96 (9th Cir. 1989).

As shown above, RICO Section 1963(a) provides only for forfeiture of assets earned in connection with racketeering activity. Because the certificates of deposit were

not forfeitable, taxpayer had no basis upon which to claim his deduction under Section 212(2). Moreover, taxpayer knew the tax law well enough to avoid claiming his deduction as a business expense under Section 162(a), and instead attempted to recharacterize the legal fees in different terms in order to receive favorable treatment under Section 212(2). This provision, as amply demonstrated by the cases discussing RICO forfeiture and the breadth of Section 212(2), does not afford taxpayer a credible argument that the law was unclear.

Additionally, taxpayer did not support with sufficient evidence his claim that he relied on the advice of counsel and his tax preparer in claiming his deduction of legal fees under Section 212(2). Even if the record had shown that taxpayer had relied in good faith on the advice of competent counsel, in contrast to taxpayer's assertion at oral argument, the Supreme Court's recent decision in *Cheek v. United States*, 111 S. Ct. 604, 611, would be of no avail because there the Court only held in a criminal case that the willful failure to pay taxes was not necessarily proven if the defendant truly believed the Internal Revenue Code did not treat wages as income. Whereas *Cheek* simply creates a jury question out of a defendant's interpretation of the Code, *id.* at 613, Section 6653 imposes a burden of production on a taxpayer.

As the Tax Court noted in its order denying a motion to vacate its decision, Accardo failed to produce the required evidence that he relied upon his tax preparer or that the preparer gave him reasonable advice. Similarly, he has not shown that he received advice from his counsel, that he relied on it in good faith, and that any such reliance was reasonable. See *Betson v. Commissioner*, 802 F.2d 365, 372 (9th Cir. 1986) (reversing imposition of negligence penalty where the record indicates that taxpayer relied in good faith on the substantive advice of his accountant). That the signature of the accountant tax preparer appeared on Accardo's tax return is not enough. Taxpayer must demonstrate that he supplied all relevant information to his tax preparer and subsequently relied

on the preparer's advice in erroneously claiming the deduction. *Pritchett v. Commissioner*, 63 T.C. 149, 174 (1974); *Pessin v. Commissioner*, 59 T.C. 473, 489 (1972). In the present case, the Tax Court properly upheld the addition to tax on the ground that the underpayment was negligent.

B. *Substantial underpayment of taxes under Section 6661*

In addition to the penalty imposed for negligent underpayment of tax, the Tax Court also imposed liability for addition to tax under Section 6661(a) of the Internal Revenue Code.[6] Under Section 6661(a) (26 U.S.C.), the taxpayer owes an addition to tax in an amount equal to 25 percent of the amount of the substantial underpayment. Section 6661(b)(1)(A) establishes that a taxpayer has substantially underpaid when the underpayment exceeds the greater of either 10 percent of the amount of tax due or $5,000.

Taxpayer makes no argument with respect to the $9,903 deficiency imposed by the Commissioner on account of taxpayer's substantial understatement of liability under Section 6661 of the Code. As noted above, taxpayer substantially understated his income tax liability for the two years in question within the meaning of Section 6661. The provision therefore will apply by virtue of the fact that taxpayer's understatement exceeded the limits set forth in the statute. However, Section 6661 permits a reduction of the penalty for understatement in either of two situations:

[6] Section 6661 was repealed effective December 19, 1989, and does not apply to tax returns due after December 31, 1989. Section 6662 of the Internal Revenue Code of 1986 now provides for the imposition of penalties for the substantial understatement of tax liability.

> (1) if there is or was substantial authority for such treatment (26 U.S.C. § 6661(b)(2)(B)(i));
>
> (2) if the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return (26 U.S.C. § 6661(b)(2)(B)(ii)).

Additionally, Section 6661(c) permits waiver of the entire penalty for understatement "if there was reasonable cause for the understatement (or part thereof) and the taxpayer acted in good faith" (Section 6661(c) (26 U.S.C.)).

The Tax Court found that taxpayer did not meet any of the above conditions, so that he was not entitled to a reduction in or waiver of the penalty for understatement. Taxpayer's claim that there was substantial authority supporting the deduction of legal fees is undercut by Treasury Regulation 1.6661-3(b)(1), limiting "substantial authority" to situations in which "the weight of the authorities supporting the treatment is substantial in relation to the weight of the authorities supporting contrary positions." Treasury Regulations on Income Tax (23 C.F.R.). As the above discussion of the non-deductibility of taxpayer's legal fees amply demonstrates, there is a dearth of authority supporting his position, much less the balance of authorities required by the Treasury Regulation.

Furthermore, taxpayer did not provide relevant facts on his tax return sufficient to permit a reduction for adequate disclosure. He stated only that his deduction of $207,000 was for "Legal fees re conservation of property held for production of income." This assertion falls short of the exposition of relevant facts required under Section 6661(b)(2)(b)(ii). *Schirmer v. Commissioner*, 89 T.C. 277, 285-286 (1987) (mere listing of income, expenses and claimed depreciation did not constitute disclosure of relevant facts). Particularly where taxpayer lacked substantial authority for his position and where he appeared to think that his deduction presented a novel legal issue, the mere declaration of a deduction does not entitle taxpayer to a reduced penalty for understatement of tax.

Finally, Section 6661(c) vests discretion in the Commissioner to reduce or waive the penalty for understatement if he believes that the taxpayer acted in good faith. As the preceding discussion of the penalty for negligent underpayment demonstrates, the record does not contain evidence of taxpayer's good faith. Given the absence of authority supporting his position, the Commissioner acted well within his discretion in concluding that the understatement was unreasonable.

The decision of the Tax Court is affirmed.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

AGENCY JUDGMENT
With Oral Argument

Date: August 21, 1991

Before: Hon. Walter J. Cummings, Circuit Judge
Hon. Richard D. Cudahy, Circuit Judge
Hon. Kenneth F. Ripple, Circuit Judge

No. 90-2649

ANTHONY J. ACCARDO AND CLARICE ACCARDO,

Petitioners-Appellants

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee

Appeal from the United States Tax Court, No. 39577-87

This cause was heard on the record from the United States Tax Court and was argued by counsel.

On consideration whereof, It Is Ordered and Adjudged by this Court that the decision of the United States Tax Court in this cause appealed from be, and the same is hereby, Affirmed with costs, in accordance with the opinion of this Court filed this date.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Date: October 9, 1991

Before: Hon. Walter J. Cummings, Circuit Judge
Hon. Richard D. Cudahy, Circuit Judge
Hon. Kenneth F. Ripple, Circuit Judge

No. 90-2649

ANTHONY J. ACCARDO AND CLARICE ACCARDO,

Petitioners-Appellants

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee

Appeal from the United States Tax Court, No. 39577-87

ORDER

On consideration of the petition for rehearing filed by appellants on September 4, 1991, all of the judges on the original panel having voted to deny same,

It Is Hereby Ordered that the aforesaid petition for rehearing be, and the same is hereby, Denied.

APPENDIX C

94 T.C. No. 8

UNITED STATES TAX COURT

ANTHONY J. ACCARDO AND
CLARICE ACCARDO, Petitioners v. COMMISSIONER
OF INTERNAL REVENUE, Respondent.

Docket No. 39577-87. Filed February 27, 1990.

Legal expenses in successful defense of RICO charges were not paid or incurred for the management, conservation, or maintenance of property held for the production of income and accordingly, are not deductible under sec. 212(2).

Carl M. Walsh, for the petitioners.
Diane L. Berkowitz, for the respondent.

OPINION

CLAPP, Judge: Respondent determined deficiencies in and additions to petitioners' federal income taxes as follows:

		Additions to Tax		
Year	*Deficiency*	*sec. 6653(a)(1)*[1]	*sec. 6653(a)(2)*	*sec. 6661*
1981	$10,196	$ 510	*	
1982	$39,612	1,981	*	$9,903

* 50 percent of the interest due on the deficiency

[1] All section references are to the Internal Revenue Code of 1954, as amended and in effect for the years in issue. All Rule references are to the Tax Court Rules of Practice and Procedure.

The case was submitted fully stipulated under Rule 122. The issues are (1) whether petitioners may deduct under section 212(2) the legal expenses they incurred in successful defense of petitioner Anthony J. Accardo in a criminal prosecution under the Racketeer Influenced and Corrupt Organizations Act; (2) whether petitioners are liable for additions to tax under section 6653(a)(1) and (2); and (3) whether petitioners are liable for an addition to tax under section 6661.

Petitioners resided in Barrington Hills, Illinois when they filed their petition. Clarice Accardo is a party only because she filed a joint income tax return with her husband. All references to "petitioner" in the singular will be to Anthony J. Accardo.

On June 3, 1981, petitioner and 15 other defendants were indicted by a federal grand jury in Florida. The relevant portions of the indictment read—

> THE GRAND JURY CHARGES:
>
> *COUNT ONE*
>
> * * *
>
> 3. From on or about October 1970 and continuously thereafter until December 31, 1977, in the Southern District of Florida and elsewhere, the defendants ANTHONY ACCARDO * * * [and others] did knowingly, willfully, and unlawfully conspire, combine, confederate, and agree together, with each other, and with other persons known and unknown to the Grand Jury, to conduct and participate, directly and indirectly, in the conduct of the affairs of the Laborers Union through a pattern of racketeering activity in violation of Title 18, United States Code Section 1962(c).
>
> 4. It was part of the conspiracy that the defendants and co-conspirators would be employed by or associated with an enterprise which was engaged in, and

the activities of which affected interstate commerce, to wit: the Laborers Union, including its subordinate bodies and affiliated benefit plans.

5. It was further part of the conspiracy that the defendants and co-conspirators would commit and cause to be committed multiple acts of racketeering activity, to wit: the unlawful payment and receipt of things of value relating to questions and matters concerning employee welfare benefit plans, in violation of Title 18, United States Code, Section 1954.

6. It was further part of the conspiracy that some of the defendants and the co-conspirators would, directly and indirectly, give, offer, and promise to give and offer fees, kickbacks, commissions, gifts, loans, money and other things of value to other defendants and co-conspirators who were administrators, officers, trustees, custodians, counsel, agents, and employees of employee welfare benefit plans, with other defendants and co-conspirators aiding abetting and counseling both of the previous groups, because of, and with intent to influence, the actions, decisions, and other duties of such defendants and co-conspirators as administrators, officers, trustees, custodians, counsel, agents and employees relating to questions and matters concerning such plan, that is, granting of welfare benefit plan dental, vision and life insurance business.

7. It was further part of the conspiracy that the defendant ANTHONY ACCARDO would agree to and support the operation of a kickback scheme involving the Laborers union initially in Chicago and Florida and eventually nationwide in return for payments of money.

* * * *

39. During 1975 defendant ANTHONY ACCARDO had a conversation with Joseph Hauser in which he advised Joseph Hauser the insurance business of the Laborers Union would be controlled by "the family"

with ACCARDO controlling the midwestern United States * * *.

* * *

All in violation of Title 18, United States Code, Section 1962(d).

THE GRAND JURY FURTHER CHARGES:

FORFEITURE

* * *

2. Through the aforesaid pattern of racketeering activity, the defendants ANTHONY ACCARDO * * * [and others] have acquired and maintained interests in violation of Title 18, United States Code, Section 1962, thereby making these interests subject to forfeiture to the United States pursuant to Title 18, United States Code, Section 1963.

3. The interests of the defendants subject to forfeiture to the United States include any and all proceeds of the pattern of racketeering alleged in Count One and any and all interests, securities, claims, and property and contractual rights acquired through use of these proceeds, including $2,064,066.32 paid and received as kickbacks as set forth in [the indictment] * * *.

4. The defendants are jointly and severally liable to the United States for this Forfeiture.

Petitioner was acquitted by the jury on June 30, 1982. On their Federal Income tax returns for 1981 and 1982, petitioners deducted legal fees of $17,500 and $207,000 respectively, that they incurred defending petitioner against the charges.

Title 18 U.S.C. sec. 1963 (1982) in effect at the time of trial provides that:

(a) Whoever violates any provision of section 1962 of this chapter shall be fined not more than $25,000 or imprisoned not more than twenty years, or both, and shall forfeit to the United States (1) any interest

> he has acquired or maintained in violation of section 1962, and (2) any interest in, security of, claim against, or property or contractual right of any kind affording a source of influence over, any enterprise which he has established, operated, controlled, conducted, or participated in the conduct of, in violation of section 1962.

The only assets, if any, that petitioner was attempting to protect against forfeiture under 18 U.S.C. sec. 1963 were three certificates of deposit of $500,000 each, and condominiums in River Forest, Illinois and Indian Wells, California that petitioners used as their personal residences. The indictment did not specifically identify these assets as property subject to forfeiture under 18 U.S.C. sec. 1963. The funds used to purchase these assets were not obtained from the alleged activities for which petitioner was indicted.

Section 212(2) provides that an individual may deduct "all the ordinary and necessary expenses paid * * * for the management, conservation, or maintenance of property held for the production of income * * * " Petitioner argues that the entire amount of the legal fees should be deductible under section 212(2) because the indictment sought a "forfeiture judgment" and petitioner accordingly incurred the legal fees to conserve and maintain income producing property (the certificates of deposit). Petitioner does not explain why he believes that none of his legal fees were incurred to conserve and maintain his other non income-producing property (the condominiums) or to keep him out of jail.

In any event, we hold for respondent. No allocation is necessary because no part of the legal fees is deductible. Petitioner's situation is no different from that of any defendant in a criminal or civil trial who faces a poten-

tial fine or monetary judgment that must be paid out of income-producing assets such as savings accounts, certificates of deposit, or stocks. In *United States v. Gilmore*, 372 U.S. 39, 46 (1963), the Supreme Court noted that the taxpayer in *Lykes v. Unites States*, 342 U.S. 118 (1952), had—

> argued that if he had been required to pay the original [gift tax] deficiency he would have been forced to liquidate his stockholdings, which were his main source of income, and that his legal expenses [contesting the deficiency] were therefore incurred in the "conservation" of income-producing property and hence deductible under * * * [the predecessor of section 212(2)]. * * *

The *Lykes* Court rejected the taxpayer's argument,[2] saying that—

> It would mean that the expense of defending almost any claim would be deductible by a taxpayer on the ground that such defense was made to help him keep clear of liens whatever income-producing property he might have. For example, it suggests that the expense of defending an action based upon personal injuries caused by a taxpayer's negligence while driving an automobile for pleasure should be deductible. [*Lykes* at 125.]

Accordingly, petitioner's position is inconsistent with *Lykes*.

Petitioner's position also is inconsistent with the holding in *Gilmore v. Commissioner*, 372 U.S. at 48. According to *Gilmore*—

> the characterization, as "business" or "personal," of the litigation costs of resisting a claim depends on

---

[2] The taxpayer now would be allowed a deduction under section 212(3).

> whether or not the claim *arises in connection with* the taxpayer's profit-seeking activities. It does not depend on the *consequences* that might result to a taxpayer's income-producing property from a failure to defeat the claim * * * [otherwise there would be] capricious results. If two taxpayers are each sued for an automobile accident while driving for pleasure, deductibility of their litigation costs would turn on the mere circumstance of the character of the assets each happened to possess, that is, whether the judgments against them stood to be satisfied out income- or non-income- producing property. * * * [emphasis in original; *Gilmore* at 48].

In the instant case, the claim arose in connection with petitioner's alleged racketeering activities, rather than in connection with the certificate of deposit or the condominiums. Forfeiture of the certificates of deposit or the condominiums was merely a possible consequence of a failure to defeat the claim. Accordingly, section 212(2) does not allow petitioners to deduct any part of their legal fees.

Petitioners assert they are not liable for the additions to tax for negligence under section 6653 (a) because they relied on the advice of their tax preparer. However, they introduced no evidence to support this argument, which was made for the first time on brief. In addition, we have found that petitioner's legal fees are not deductible under *Gilmore*, and there was no evidence that petitioners made any effort to determine the propriety of their claimed deductions or to establish any plausible arguments in support of the deductions. Negligence under section 6653(a) is the lack of due care or failure to act as a reasonable person would act. *Neely v. Commissioner*, 85 T.C. 934, 947 (1985). Petitioners bear the burden of proof with respect to additions to tax for negligence. Rule 142(a); *Luman v. Commissioner*, 79 T.C. 846, 860 (1982). Petitioners have not carried their burden of proof.

Petitioners had a substantial understatement of income tax in 1982. Section 6661(b)(1)(A). Accordingly, they are liable for the section 6661 addition to tax unless one of the exceptions of section 6661(b)(2)(b) applies. The exception of section 6661(b)(2)(B)(i) will not apply because as discussed above there was no substantial authority for petitioner's treatment of the legal fees. The exception of section 6661(b)(2)(B)(ii) will not apply because petitioners' 1982 return merely stated "Legal fees re conservation of property held for production of income", which is not adequate disclosure of the relevant facts affecting the tax treatment for legal fees. Accordingly, petitioners are liable for the addition to tax under section 6661.

We do not rule on petitioner's relevancy objection to petitioner's testimony before the Senate subcommittee because we have not relied on that testimony.

Decision will be entered for the respondent.

APPENDIX D

18 U.S.C. SECTION 1962 Prohibited activities

(a) It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal within the meaning of section 2, title 18, United States Code, to use or invest, directly or indirectly, any part of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engages in, or the activities of which affect, interstate or foreign commerce.

A purchase of securities on the open market for purposes of investment, and without the intention of controlling or participating in the control of the issuer, or of assisting another to do so, shall not be unlawful under this subsection if the securities of the issuer held by the purchaser, the members of his immediate family, and his or their accomplices in any pattern or racketeering activity or the collection of an unlawful debt after such purchase do not amount in the aggregate to one percent of the outstanding securities of any one class, and do not confer, either in law or in fact, the power to elect one or more directors of the issuer.

(b) It shall be unlawful for any person through a pattern of racketeering activity or through collection of an unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.

(c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct

of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

(d) It shall be unlawful for any person to conspire to violate any of the provisions of subsection (a), (b), or (c) of this section. Added Oct. 15, 1970, P. L. 91-452, Title IX Section 901 (a), 84 Stat. 942; Nov. 18, 1988, P.L.100-690, Title VII, Subtitle B, Section 7033, 102 Stat. 4398.)

APPENDIX E

18 U.S.C. SECTION 1963 Criminal penalties

(a) Whoever violates any provision of section 1962 of this chapter shall be fined under this title or imprisoned not more than 20 years (or for life if the violation is based on a racketeering activity for which the maximum penalty includes life imprisonment), or both [.], and shall forfeit to the United States, irrespective of any provisions, irrespective of any provision of State law—

(1) any interest the person has acquired or maintained in violation of section 1962;

(2) any—

(A) interest in;

(B) security of;

(C) claim against; or

(D) property or contractual right of any kind affording a source of influence over;

any enterprise which the person has established, operated, controlled, conducted, or participated in the conduct of, in violation of section 1962; and

(3) any property constituting, or derived from, any proceeds which the person obtained, directly or indirectly, from racketeering activity or unlawful debt collection in violation of section 1962.

The court, in imposing sentence on such person shall order, in addition to any other sentence imposed pursuant to this section, that the person forfeit to the United States all property described in this subsection. In lieu of a fine otherwise authorized by this section, a defendant who derives profits or other proceeds from an offense may be fined not more than twice the gross profits or other proceeds.

(b) Property subject to criminal forfeiture under this section includes—

(1) real property, including things growing on, affixed to, and found in land; and

(2) tangible and intangible personal property, including rights, privileges, interests, claims, and securities.

(c) All right, title, and interest in property described in subsection (a) vests in the United States upon the commission of the act giving rise to forfeiture under this section. Any such property that is subsequently transferred to a person other than the defendant may be the subject of a transferred to a person other than the defendant may be the subject of a special verdict of forfeiture and thereafter shall be ordered forfeited to the United States, unless the transferee establishes in a hearing pursuant to subsection (1) that he is a bona fide purchaser for value of such property who at the time of purchase was reasonably without cause to believe that the property was subject to forfeiture under this section.

(d)(1) Upon application of the United States, the court may enter a restraining order or injunction, require the execution of a satisfactory performance bond, or take any other action to preserve the availability of property described in subsection (a) for forfeiture under this section—

(A) upon the filing of an indictment or information charging a violation of section 1962 of this chapter and alleging that the property with respect to which the order is sought would, in the event of conviction, be subject to forfeiture under this section; or

(B) prior to the filing of an indictment or information, if, after notice to persons appearing to have an interest in the property and opportunity for a hearing, the court determines that—

(i) there is a substantial probability that the United States will prevail on the issue of forfeiture and that failure to enter the order will result in the property being destroyed, removed from the jurisdiction of the

court, or otherwise made unavailable for forfeiture; and

(ii) the need to preserve the availability of the property through the entry of the requested order outweighs the hardship on any party against whom the order is to be entered:

Provided, however, That an order entered pursuant to subparagraph (B) shall be effective for not more than ninety days, unless extended by the court for good cause shown or unless an indictment or information described in subparagraph (A) has been filed.

(2) A temporary restraining order under this subsection may be entered upon application of the United States without notice or opportunity for a hearing when an information or indictment has not yet been filed with respect to the property, if the United States demonstrated that there is probable cause to believe that the property with respect to which the order is sought would, in the event of conviction, be subject to forfeiture under this section and that provision of notice will jeopardize the availability of the property for forfeiture. Such a temporary order shall expire not more than ten days after the date on which it is entered, unless extended for good cause shown or unless the party against whom requested concerning an order entered under this paragraph shall be held at the earliest possible time, and prior to the expiration of the temporary order.

(3) The court may receive and consider, at a hearing held pursuant to this subsection, evidence and information that would be inadmissible under the Federal Rules of Evidence [28 USCS Appx].

(e) Upon conviction of a person under this section, the court shall enter a judgment of forfeiture of the property to the United States and shall also authorize the Attorney General to seize all property ordered forfeited upon such terms and conditions as the court shall deem proper. Following the entry of an order declaring the property

forfeited, the court may, upon application of the United States, enter such appropriate restraining orders or injunctions, require the execution of satisfactory performance bonds, appoint receivers, conservators, appraisers, accountants, or trustees, or take any other action to protect the interest of the United States in the property ordered forfeited. Any income accruing to, or derived from, an enterprise or an interest in an enterprise which has been ordered forfeited under this section may be used to offset ordinary and necessary to protect the interests of the United States or third parties.

(f) Following the seizure of property ordered forfeited under this section, the Attorney General shall direct the disposition of the property by sale or any other commercially feasible means, making due provision for the rights of any innocent persons. Any property right or interest not exercisable by, or transferable for value to, the United States shall expire and shall not revert to the defendant, nor shall the defendant or any person acting in concert with or on behalf of the defendant be eligible to purchase forfeited property at any sale held by the United States.

Upon application of a person, other than the defendant or a person acting in concert with or on behalf of the defendant, the court may restrain or stay the sale or disposition of the property pending the conclusion of any appeal of the criminal case giving rise to the forfeiture, if the applicant demonstrates that proceeding with the sale or disposition of the property will result in irreparable injury, harm or loss to him. Notwithstanding 31 U.S.C. 3302(b), the proceeds of any sale or other disposition of property forfeited under this section and any moneys forfeited shall be used to pay all proper expenses for the forfeiture and the sale, including expenses of seizure, maintenance and custody of the property pending its disposition, advertising and court costs. The Attorney General shall deposit in the Treasury any amounts of such proceeds or moneys remaining after the payment of such expenses.

(g) With respect to property ordered forfeited under this section, the Attorney General is authorized to—

(1) grant petitions for mitigation or remission of forfeiture, restore forfeited property to victims of a violation of this chapter [18 PREPARE Section 1961 et seq.];

(2) compromise claims arising under this section;

(3) award compensation to persons providing information resulting in a forfeiture under this section;

(4) direct the disposition by the United States of all property order forfeited under this section by public sale or any other commercially feasible means, making due provision for the rights of innocent persons, and

(5) take appropriate measures necessary to safeguard and maintain property ordered forfeited under this section pending its disposition.

(h) The Attorney General may promulgate regulations with respect to—

(1) making reasonable efforts to provide notice to persons who may have an interest in property ordered forfeited under this section;

(2) granting petitions for remission or mitigation of forfeiture;

(3) the restitution of property to victims of an offense petitioning for remission or mitigation of forfeiture under this [18 PREPARE Section 1961 et. seq.];

(4) the disposition by the United States forfeited property by public sale or other commercially feasible means;

(5) the maintenance and safekeeping of any property forfeited under this section pending its disposition and

(6) the compromise of claims arising under this chapter [18 PREPARE Section 1961 et seq.].

Pending the promulgation of such regulations, all provisions of law relating to the disposition of property, or the proceeds from the sale thereof, or the remission or

mitigation of forfeitures for violation of the customs laws, and the compromise of claims and the award of compensation to informers in respect of such forfeitures shall apply to forfeitures incurred, or alleged to have been incurred, under the provisions of this section, insofar as applicable and not inconsistent with the provisions hereof. Such duties as are imposed upon the Customs Service or any person with respect to the disposition of property under the customs law shall be performed under this chapter be performed under this chapter [18 PREPARE Section 1961 et seq.]; by the Attorney General.

(i) Except as provided in sub section (1), no party claiming an interest in property subject to forfeiture under this section may—

(1) intervene in a trial or appeal of a criminal case involving the forfeiture of such property under this section; or

(2) commence an action at law or equity against the United States concerning the validity of his alleged interest in the property subsequent to the filing of an indictment or information alleging that the property is subject to forfeiture under this section.

(j) The district courts of the United States shall have jurisdiction to enter orders as provided in this section without regard to the location of any property which may be subject to forfeiture under this section or which has been ordered forfeited under this section.

(k) In order to facilitate the identification or location of property declared forfeited and to facilitate the disposition of petitions for remission or mitigation of forfeiture, after the entry of an order declaring property forfeited to the united States the court may, upon application of the United States, order that the testimony of any witness relating to the property forfeited be taken by deposition and that any designated book, paper, document, record, recording, or other material not privileged be produced at the same time and place, in the same manner

as provided for the taking of depositions under Rule 15 of the Federal Rules of Criminal procedure [PREPARE Rules of Criminal Procedure, Rule 15].

(l) (1). Following the entry of an order of forfeiture under this section, the United States shall publish notice of the order and of its intent to dispose of the property in such manner as the Attorney General may direct. The Government may also, to the extent practicable, provide direct written notice to any person known to have alleged an interest in the property that is the subject of the order of forfeiture as a substitute for published notice as to those persons so notified.

(2) Any person, other than the defendant, asserting a legal interest in property which has been ordered forfeited to the United States pursuant to this section may, within thirty days of the final publication of notice or his receipt of notice under paragraph (1), whichever is earlier, petition the court for a hearing to adjudicate the validity of his alleged interest in the property. The hearing shall be held before the court alone, without a jury.

(3) The petition shall be signed by the petitioner under penalty of perjury and shall set forth the nature and extent of the petitioner's right, title, or interest in the property, the time and circumstances of the petitioner's acquisition of the right, title, or interest in the property, any additional facts supporting the petitioner's claim, and the relief sought.

(4) The hearing on the petition shall, to the extent practicable and consistent with the interests of justice, be held within thirty days of the filing of the petition. The court may consolidate the hearing on the petition with a hearing on any other petition filed by a person other than the defendant under this subsection.

(5) At the hearing, the petitioner may testify and present evidence and witnesses on his own behalf, and cross-examine witnesses who appear at the hearing. The United States may present evidence and witnesses in rebuttal and

in defense of its claim to the property and cross-examine witnesses who appear at the hearing. In addition to testimony and evidence presented at the hearing, the court shall consider the relevant portions of the record of the criminal case which resulted in the order of forfeiture.

(6) If, after the hearing, the court determines that the petitioner has established by a preponderance of the evidence that—

(A) the petitioner has a legal right, title, or interest in the property, and such right, title, or interest renders the order of forfeiture invalid in whole or in part because the right, title, or interest was vested in the petitioner rather than the defendant or was superior to any right, title, or interest of the defendant at the time of the commission of the acts which gave rise to the forfeiture of the property under this section; or

(B) the petitioner is a bona-fide purchaser for value of the right, title or interest in the property and was at the time of purchase reasonably without cause to believe that the property was subject to forfeiture under this section;

the court shall amend the order of forfeiture in accordance with its determination.

(7) Following the court's disposition of all petitions filed under this subsection, or if no such petitions are filed following the expiration of the period provided in paragraph (2) for the filing of such petitions, the United States shall have clear title to property that is the subject of order of forfeiture and may warrant good title to any subsequent purchaser or transferee.

(m) If any of the property described in subsection (a), as a result of any act or omission of the defendant—

(1) cannot be located upon the exercise of due diligence;

(2) has been transferred or sold to, or deposited with, a third party;

(3) has been placed beyond the jurisdiction of the court;

(4) has been substantially diminished in value; or

(5) has been commingled with other property which cannot be divided without difficulty;

the court shall order the forfeiture of any other property of the defendant up to the value of any property described in paragraphs (1) through (5).

APPENDIX F

26 U.S.C. SECTION 162 Trade or business expense

(a) In general.

There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

For purposes of the preceding sentence, the place of residence of a Member of Congress (including any Delegate and Resident Commissioner) within the State, congressional district, or possession which he represents in Congress shall be considered his home, but amounts expended by such members within each taxable year for living expenses shall not be deductible for income tax purposes in excess of $3,000.

APPENDIX G

26 U.S.C. SECTION 212 Expenses for production of income.

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income; or

(3) in connection with the determination, collection or refund of any tax.

APPENDIX H

26 U.S.C. SECTION 6653 Additions to Tax For Negligence and Fraud

(a) Negligence.

"(1) In general, if any part of any underpayment (as defined in subsection (c) of tax required to be shown on a return is due to negligence (or disregard of rules or regulations), there shall be added to the tax an amount equal to 5 percent of the underpayment.

(2) Underpayment taken into account reduced by portion attributable to fraud with respect to which a penalty is imposed under subsection (b).

(3) Negligence. For purposes of this subsection, the term negligence includes any failure to make a reasonable attempt to comply with the provisions of this title, and term 'disregard' includes any careless, reckless, or intentional disregard.

"(b) Fraud.

"(1) In general, if any part of any underpayment (as defined in subsection (c) of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 75 percent of the portion of the underpayment which is attributable to fraud.

"(2) Determination of portion attributable to fraud. If the Secretary establishes that any portion of an underpayment is attributable to fraud, the entire underpayment shall be treated as attributable to fraud, except with respect to any portion of the underpayment which the taxpayer establishes is not attributable to fraud.

"(3) Special rule for joint returns. In the case of a joint return, this sub section shall not apply with respect to a spouse unless some part of the underpayment is due to the fraud of such spouse.

"(c) Definition of underpayment. For purposes of this section, the term 'underpayment' means—

"(1) Income, estate, gift, and certain excise taxes. In the case of a tax to which section 6211 (relating to income, estate, gift, and certain excise taxes) is applicable, a deficiency as defined in the section (except that, for this purpose, the tax shown on a return referred to in section 6211(a)(1)(A) shall be taken into account only if such return was filed on or before the last day prescribed for the filing of such return, determined with regard to any extension of time for such filing), and

"(2) Other taxes. In the case of any other tax, the amount by which such tax imposed by this title exceeds the excess of—

"(A) The sum of-

"(i) The amount shown as the tax by the taxpayer upon his return (determined without regard to any credit for an overpayment for any prior period, and without regard to any adjustment under authority of sections 6205(a), and 6413(a), if a return was made by the taxpayer within the time prescribed for filing such return (determined with regard to any extension of time for such filing) and an amount was shown as the tax by the taxpayer thereon, plus

"(ii) Any amount, not shown on the return, paid in respect of such tax, over—

"(B) The amount of rebates made. For purposes of subparagraph (B), the term "rebate" means so much of an abatement, credit, refund, or other repayment, as was made on the ground that the tax imposed was less than the excess of the amount specified in subparagraph (A) over the rebates previously made.

"(d) No delinquency penalty if fraud assessed. If any penalty is assessed under subsection (b) (relating to fraud) for an underpayment of tax which is required to be shown on a return, no penalty under section 6651 (relating to failure to file such return or pay tax) shall be assessed with respect to the portion of the underpayment which is attributable to fraud.

APPENDIX I

26 U.S.C. SECTION 6661 Substantial Understatement of Liability.

"(a) Addition to tax. "If there is a substantial understatement of income tax for any taxable year, there shall be added to the tax an amount equal to 25 percent of the amount of any underpayment attributable to such understatement.

"(b) Definition and special rule.

"(1) Substantial understatement.

"(A) In general. For purposes of this section, there is a substantial understatement of income tax for any taxable year if the amount of the understatement for the taxable year exceeds the greater of—

"(i) 10 percent of the tax required to be shown on the return for the taxable year, or

"(ii) $5,000.

"(B) Special rule for corporations. In the case of a corporation other than an S corporation or a personal holding company (as defined in section 542), paragraph (1) shall be applied by substituting '$10,000' for '$5,000'.

"(2) Understatement.

"(A) In general. For purposes of paragraph (1), the term 'understatement' means the excess of—

"(i) the amount of the tax required to be shown on the return for the taxable year, over

"(ii) the amount of tax imposed which is shown on the return, reduced by any rebate (within the meaning of section 6211(b)(2).

"(B) Reduction for understatement due to position of taxpayer or disclosed item. The amount of the understatement under subparagraph (A) shall be reduced by that portion of the understatement which is attributable to—

"(i) the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment, or

"(ii) any item with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return.

"(C) Special rules in cases involving tax shelters.

"(i) In general. In the case of any item attributable to a tax shelter—

"(I) subparagraph (B)(ii) shall not apply, and

"(II) subparagraph (B)(i) shall not apply unless (in addition to meeting the requirements of such subparagraph) the taxpayer reasonably believed that the tax treatment of such item by the taxpayer was more likely than not the proper treatment.

"(ii) Tax shelter. For purposes of clause (i), the term 'tax shelter' means—

"(I) a partnership or other entity,

"(II) any investment plan or arrangement, or

"(III) any other plan or arrangement, "if the principal purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.

"(3) Coordination with penalty imposed by section 6659. For purposes of determining the amount of the addition to tax assessed under subsection (a), there shall not be taken into account the portion of the substantial understatement on which a penalty is imposed under section 6659 (relating to addition to tax in the case of valuation overstatements).

"(c) Authority to waive. "The Secretary may waive all or any part or the addition to tax provided by this section on a showing by the taxpayer that there was reasonable cause for the understatement (or part thereof) and that the taxpayer acted in good faith."